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Rule Of Thumb Is Extinguished

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Uniloc v. Microsoft

- "This court now holds as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation."
- 632 F.3d 1292, 1315 (Fed. Cir. 2011)

Rule of Thumb

- The history of the rule
- How was it applied by Uniloc's expert?
- How is the rule flawed?
- What should the experts look to generally?
- Did the Entire Market Value rule change?
- Real-life examples of proper damages analyses.

35 U.S.C. 284

- "Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer…."
- The reasonable royalty is determined on the basis of a "hypothetical negotiation" at the time infringement began
  - When the patent issues
  - When the accused product began shipping

What is the 25% Rule?

- The rule suggests that a licensee pay a royalty rate of 25% of its expected profits for the product that incorporates the IP at issue.
- The rule leaves the licensee with 75 % of the profits to account for its development costs, commercial risks, its own contributions, etc.
- Had often been used as a starting point in damages analyses in patent cases, and then adjusted up or down based on other factors.

Where did the 25% Rule come from?

- Often credited to Robert Goldscheider, who wrote an article tracing the rule back to as early as 1938.
- Goldscheider did a study on a series of licenses from the 1950s that averaged 25% of licensee's profits
- Link to Goldscheider's recent article:

  http://www.bu.edu/otd/files/2009/11/goldscheider-25-percent-rule.pdf

More support for the rule

- A 1997 study of licensing organizations indicated use of the 25 % rule as a starting point in negotiations.

Uniloc Background

- Patent directed to a system for registering or activating software on a CD using a code to unlock/activate it to prevent a CD with the software on it from being re-installed on another computer.
- Accused product was Microsoft's product activation key for Microsoft Word and Microsoft Windows XP

Uniloc's expert's methodology

- Relied on Microsoft internal document that stated the product activation key was worth anywhere between $10 and $10,000 depending on the usage.
- Chose the lowest end of that range ($10) as the value of the product activation feature
- Applied the 25% Rule, which he said meant that 25% of the value of the product goes to patent owner, and 75% of the value stays with Microsoft.
- The rate he set was $2.50 per license
- Note that this was not 25% of the profits, but 25% of the "value" of the technology to Microsoft.

Uniloc's expert's methodology

- He then looked at a set of factors known as the Georgia Pacific factors to determine whether the $2.50 should be adjusted up or down
- He concluded that $2.50 was about right
- Multiplied $2.50 by about 226 million licenses sold by Microsoft to come to $565 million in damages

Uniloc's expert's check against his calculation

- Expert used the Entire Market Value rule as a check to determine whether his other calculation was reasonable.
  - First estimated the total revenue of all the accused products based on an average selling price of $85 per unit, which came to about $20 billion
  - Then divided his damages figure of $565 million by $20 billion which he said resulted in a 2.9% royalty rate.
  - Because 2.9% was well below the "industry royalty rate" for software of 10%, it was reasonable.

Microsoft's objections to the 25% rule at trial

- Microsoft filed a motion *in limine* to exclude the expert's testimony because it was based on the 25% rule.
- District court denied Microsoft's motion because the 25% rule had been widely accepted.

Microsoft's objections to use of the entire market value rule

- Microsoft objected to Uniloc's expert using the Entire Market Value rule as a check, arguing:
  - Product Activation was not the "basis of consumer demand" for Microsoft Office or Windows
- District Court agreed with Microsoft and granted a new trial on damages because the "$19 billion cat was never put back into the bag" and the jury may have "used the $19 billion figure to check its significant award of $388 million."

Fed Cir *Uniloc* decision criticizes the rule of thumb

- Does not consider the relationship between the patent and the accused product
  - Importance of the patent to the profits?
  - Availability of close substitutes (noninfringing alternatives)?
- Does not look at the patent
  - 25% may be overly generous to narrow patents
  - 25% may be too stingy for broad patents

Fed Cir *Uniloc* decision criticizes the rule

- Does not consider the relationship between the parties
  - e.g., Are they competitors?
- The rule is essentially arbitrary
  - Does not relate to a hypothetical negotiation that took place just prior to when infringement began

Fed Cir *Uniloc* decision criticizes the rule

- Relying on the 25% rule is even more unreliable than relying on unrelated licenses (which was rejected by *ResQNet*)
- Cannot just use 25% as a starting point because you then begin with a "fundamentally flawed premise"
  - Adjusting up or down based on legitimate grounds results in a flawed conclusion.

Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993)

- *Uniloc* cited Daubert and Rule 702, Fed. R. Evid.
  - Requires "judge to determine that the testimony was based on firm scientific or technical grounding"

Uniloc holding:

- "This court now holds as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 per-cent rule of thumb is thus inadmissible under Daubert and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue."

Requirements of expert testimony under *Uniloc*

- Patentee must sufficiently tie the expert testimony to the facts of the case or else it is excluded.
- Evidence unrelated to the claimed invention does not support compensation for infringement but punishes beyond the reach of the statute.

What evidence is tied to the patent?

- Licenses
  - Patentee cannot rely on license agreements that are radically different from the hypothetical agreement under consideration. *Lucent Techs v. Microsoft*, 580 F.3d 1301 (Fed. Cir. 2009)
  - Licenses without a relationship to the claimed invention cannot form the basis of a reasonable royalty calculation. *ResQNet v. Lansa*, 594 F.3d 860 (Fed. Cir. 2010).

What evidence is tied to the patent?

- Licenses
  - Must be sufficiently comparable to the hypothetical license at issue in suit. *Lucent Techs*.
  - Must be commensurate with what the defendant has appropriated. *ResQNet*
  - Must have an economic or other link to the technology in question. *ResQNet*
  - Must be linked to the economic demand for the claimed technology. *ResQNet*

Uniloc requires a tie to the patent

- "there must be a basis in fact to associate the royalty rates used in prior licenses to the particular hypothetical negotiation at issue in the case."
- "The 25 percent rule of thumb as an abstract and largely theoretical construct fails to satisfy this fundamental requirement."
  - Not tied any particular technology
  - Not tied any particular industry
  - Not tied any particular party

Does *Uniloc* leave the door open to use the 25% Rule?

- Federal Circuit criticized expert for relying on 25% Rule because it was unrelated to the facts of the case
  - Fed Cir noted that expert testified "it's generally accepted" and "I've used it. I've seen others use it"
  - Expert did not testify that the parties had a practice of beginning negotiations at a 25% / 75% split
  - Expert did not base his use of 25% on other licenses involving the patent or comparable licenses

Uniloc on the Entire Market Value

- Expert used Entire Market Value Rule as a check
- EMV "allows a patentee to assess damages based on the entire market value of the accused product only where the patented feature creates
  - the 'basis for customer demand' or
  - 'substantially create[s] the value of the component parts.'"

Uniloc on the Entire Market Value

- Expert used Entire Market Value
  - Showed that his damages figure was only 2.9 % of total revenues of the accused product
  - Put up a pie chart showing what Microsoft gets to keep.
  - Showed that Microsoft's damages expert's royalty figure was only 0.0003% of the total revenue, and that Microsoft got to "keep 99.9999% of the box".
    - Fed Cir said this "derision" of Microsoft's expert may have "inappropriately contributed to the jury's rejection of his calcluations."

Uniloc on the Entire Market Value

- Microsoft argued using EMV was not proper because product activation (the patented feature) "did not create the basis for customer demand or substantially create the value of the component parts."
- Uniloc argued that:
  - EMV of the product can be used if the royalty rate is low enough, and
  - $19 billion was only used as a check, not as the basis of damages.

Uniloc on the Entire Market Value

- Can you rely on EMV if the royalty rate is low enough?
  - Uniloc district court relied on this statement from the Lucent Techs. case: "the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence)."
  - Fed Cir said No! this was taken out of context.
    - Cannot consider EMV for minor patent improvements simply by using a low enough royalty rate.

Uniloc on the Entire Market Value

- Fed Cir agreed with the district court that "the $19 Billion cat was never put back into the bag"
- Putting $19 Billion in revenue "cannot help but skew the damages horizon for the jury."
- "This is in clear derogation of the entire market value rule, because the entire market value of the accused products has not been shown to be derived from the patented contribution."
- The fact that EMV was only a check "is of no moment"

Uniloc on the Entire Market Value

- *Uniloc* cited 1884 Supreme Court case that required that the "the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature."

  Garretson v. Clark, 111 U.S. 120, 121.

What licenses are tied to the patent?

- *ResQNet v Lansa*, 594 F.3d 860 (Fed. Cir. 2010)
  - "the trial court must carefully tie proof of the damages to the claimed invention's footprint in the marketplace"
  - "any evidence unrelated to the claimed invention does not support compensation for infringement but punishes beyond the reach of the statute."

ResQNet v Lansa

- 7 licenses considered by the plaintiff's expert
  - 5 for software and services "rebundling agreements"
    - Rates between 25% and 40%
  - 2 straight licenses arising out of litigation of the patents in suit.
    - One was lump-sum
    - Other was a running royalty likely around 5%
- Expert concluded 12.5% was reasonable

ResQNet v Lansa

- Fed Cir said the Court made no effort to link the 5 bundling licenses to the infringed patent
  - None of these 5 licenses mentioned the patents in suit
  - No evidence that the software and services embodied the patents in suit (other than conclusory statements by the damages expert).
- Defendant used no damages expert
  - Fed Cir said it was Plaintiff's burden to offer sufficient evidence regarding an appropriate royalty

ResQNet v Lansa

- The two straight patent licenses were the most reliable ones
  - Fed Cir recognized that litigation can "skew the results of the hypothetical negotiation" because of the threat of high litigation costs.
  - Fed Cir also recognized that widespread infringement can artificially depress past licenses
- Reasonable royalty based on the re-bundling licenses "violates the statutory requirement that damages be 'adequate to compensate for the infringement.' "

ResQNet v Lansa

- Lengthy Judge Newman Dissent
  - Damages expert said that the software was based on the technology described in the patents
  - Evidence was unrebutted (defendant had no expert)
  - Expert testified to GP factor #12: customary profit for use of the invention or analogous inventions
    - Expert discussed "oft-utilized 25% rule"
    - Explained the 12.5 % royalty rate was within this rule

ResQNet v Lansa

- Take-away:
  - Tie software / services agreements to patents
    - liability expert can testify how the software sold embodies the patents in suit.
  - Can use litigation settlements
  - Don't cite the 25% rule

How have district courts interpreted *Uniloc* and *ResQNet*?

- *VS Technologies v Twitter,* 2011 US Dist LEXIS 114975 (ED Va October 5, 2011)
  - Method and system for creating an interactive virtual community of famous people, or those who wish to attain the status of a famous person
  - Plaintiff's expert relied on Twitter documents that measured new users' use of Twitter during the first week following their use of the allegedly infringing feature, which showed 5% to 7% of those users increasing their use of Twitter that week
  - Expert then apportioned incremental revenue of $73 to $102 million based on that incremental use.

How have district courts interpreted *Uniloc* and *ResQNet*?

- *VS Technologies v Twitter,* 2011 US Dist LEXIS 114975 (ED Va October 5, 2011)
  - Expert then opined that VS Tech "would be entitled to somewhere between 15% and 40% of those calculations" based on his 40 years of experience
  - The district court allowed this testimony, distinguishing *Uniloc* because it was based on an arbitrary general rule.
  - District court said that here, unlike *Uniloc*, the expert's "opinion is rendered on the basis of his experience."
  - Is this royalty is "tied to the patent" ?

How have district courts interpreted *Uniloc* and *ResQNet*?

- *Inventio v. Otis Elevator*, 2011 U.S. Dist. LEXIS 88965 (SDNY June 22, 2011)
  - Plaintiff's expert relied on entire market value rule.
  - District Court acknowledged *Uniloc's* warning against admitting this theory when the patented feature did not create the basis for customer demand
  - "It is not enough to present evidence that the patented feature was desirable, or that it played some role – even a substantial role – in the customer's decision to purchase…."
  - Court noted no evidence of customer surveys or interviews showing why customers selected the accused product
  - Court precluded evidence of entire market value.

How have district courts interpreted *Uniloc* and *ResQNet*?

- *Mondis Technology v LG Electronics et al.*, 2011 U.S. Dist. LEXIS 78482 (ED Tx June 14, 2011)
  - Patented feature did not create the basis for customer demand
  - Defendant's expert relied on licenses that were based on a percentage of the total accused product sales.
  - The district court recognized *Uniloc*, but stated disagreed with the defendant that Entire Market Value Rule required the patented feature to be the basis of the customer demand where "the most reliable licenses [for the patented technology] are based on the entire value of the licensed products."

New Patent Act – Virtual Marking

- § 287(a) amended so that a product can be marked by affixing the word "patent" "together with an address of a posting on the Internet, accessible to the public without charge for accessing the address, that associates the patented article with the number of the patent…."
- Applies to any case pending or commenced on or after the date of the Act.

New Patent Act – False Marking

- § 292 amended with "Only the United States may sue for the penalty authorized by this subsection."
- "The marking of a product … with matter relating to a patent that covered that product but has expired is not a violation of this section."
- Applies to "all cases, without exception" pending or commenced on or after the date of the Act
  - Should effectively shut down all the pending cases

New Patent Act – False Marking

- § 292 amended to carve out a new cause of action for competitors:

  "A person who has suffered competitive injury as a result of a violation of this section may file a civil action in a district court of the United States for recovery of damages adequate to compensate for the injury."

New Patent Act – False Marking

- So, must show

  (1) you're a competitor

  (2) a falsely marked product (but not just an expired patent)

  (3) you were damaged by the false marking

- You get actual damages – not the statutory amount.

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Apportionment and the EMVR Post-*Uniloc*

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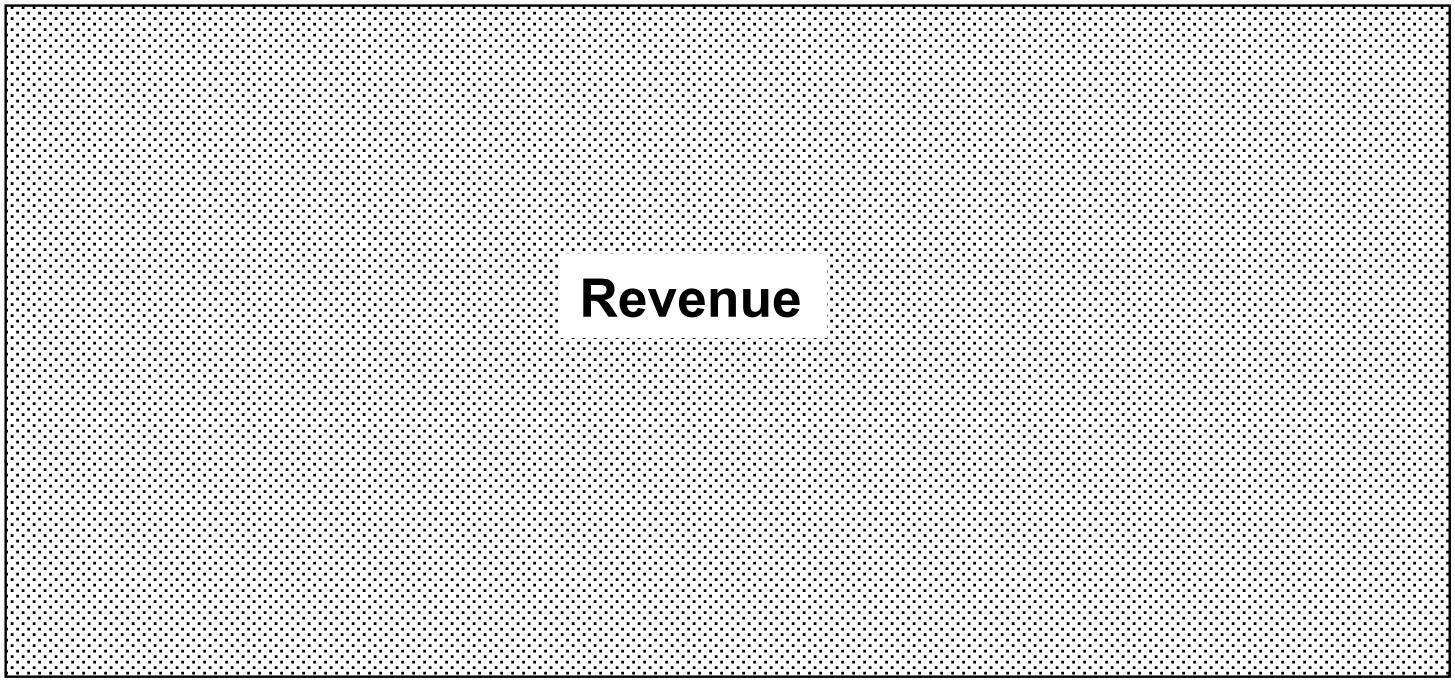
The Entire Market Value Rule

What Is It (Exactly)?

Price

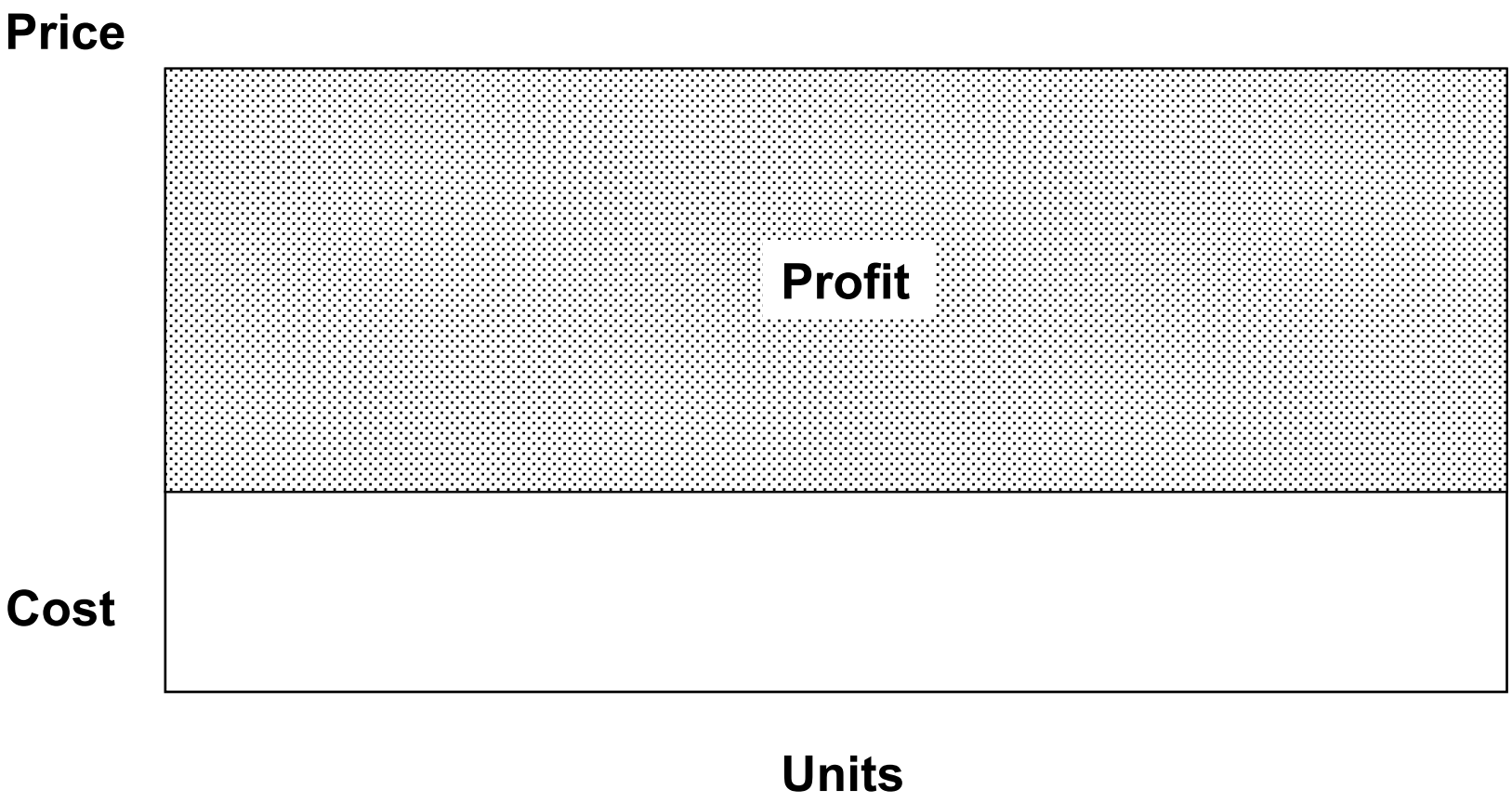


Units

Revenue = Price x Units

The Entire Market Value Rule

What Is It (Exactly)?



Revenue = Price x Units

Profit = Revenue – Cost

The Entire Market Value Rule

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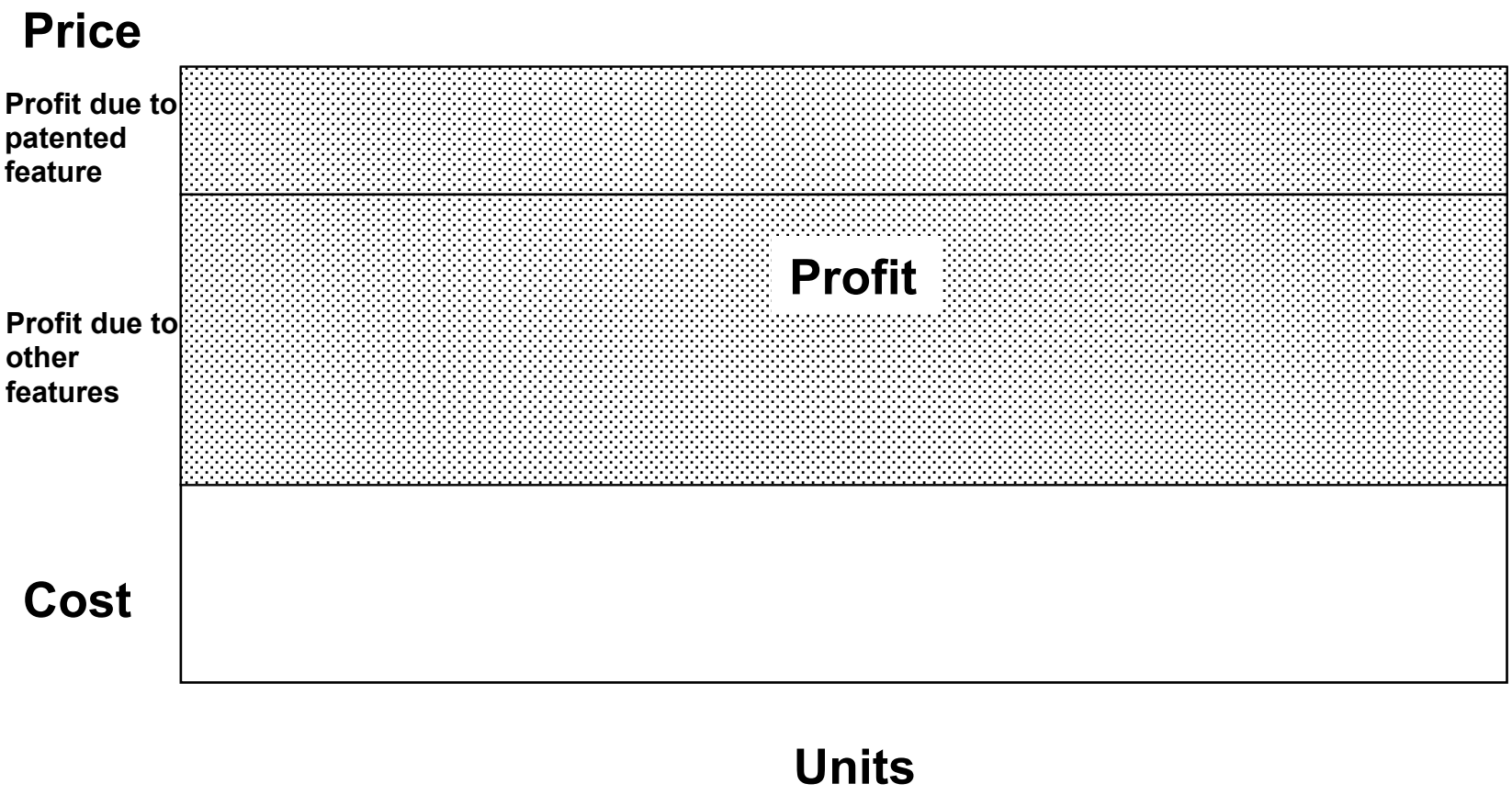

Revenue = Price x Units

Profit = Revenue – Cost

The Federal Circuit's "advance" – 1

- If profit must be apportioned, then revenue (the "royalty base") must be apportioned too
  - and you may have to apportion both quantity (to reflect "use") and price (to reflect multiple features)

The Entire Market Value Rule

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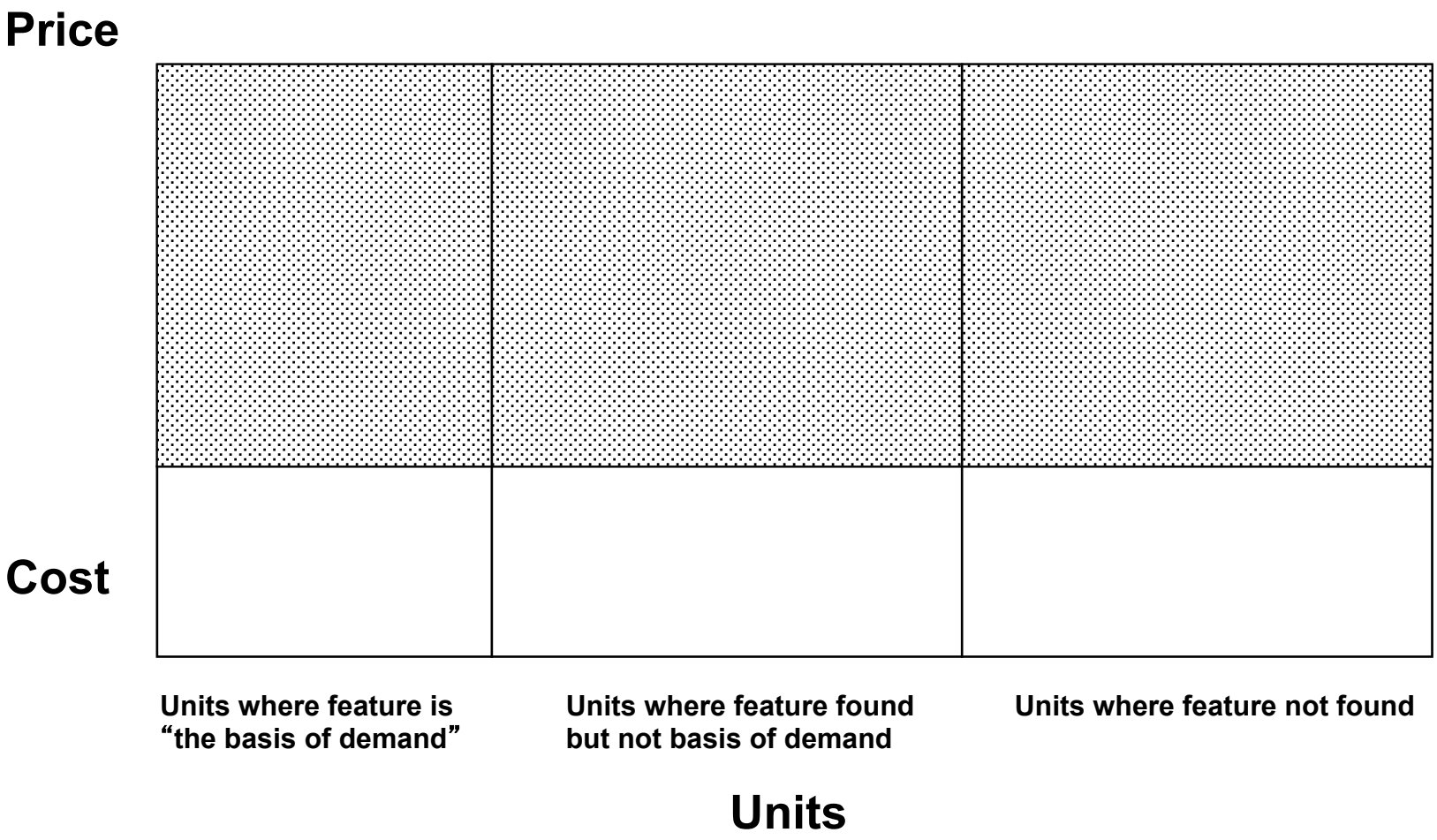

"Apportioning" the quantity

- "Dr. Jay's survey results showed that 7% of Outlook purchase-decision makers that use the drop-down calendar feature would not have bought Outlook if it lacked the drop-down calendar. [Microsoft's expert] multiplied the 7% by the percentage of all Outlook users who use the drop-down calendar—43%—to arrive at 3%.... This evidentiary record supports the conclusion that Microsoft would face a potential loss of [109 million x 3% =] 3.3 million licenses at the hypothetical negotiation if Microsoft did not include the Day patent technology in Outlook."
- "The Court concludes that Lucent's initial apportionment of 7% of the purchase-decision makers for Outlook who would not buy Outlook without the drop-down calendar with 43% who use the drop-down calendar sought to apportion between the patented and unpatented features as required by *Uniloc.*"

Order Granting in Part and Denying in Part Microsoft's Motion for Judgment as a Matter of Law and in the Alternative, a New Trial with a Remittur, November 10, 2011

"Apportioning" the price

- "Though Lucent discounts the base to include only the revenue from Outlook where a user uses the Day patent technology, Lucent fails to show that it is entitled to capture this entire market value as the base. Specifically, Lucent has not shown that the Day patent technology is the basis for consumer demand for most Outlook users. At best, Lucent has introduced evidence to show that the Day patent technology is the basis for consumer demand for about 7% of users based on the Jay survey
- "For a product that is feature-rich like Outlook, use as a proxy for value does not appropriately account for all the other unpatented features that consumers use besides the Day patent technology even when consumers invoke the Day patent methods…"
- "Put into concrete terms, if a sample user uses the infringing Day patent technology but also uses many other features in Outlook, Lucent has not shown that it is entitled to include in the royalty base all $67 of revenue generated from this sample user…"

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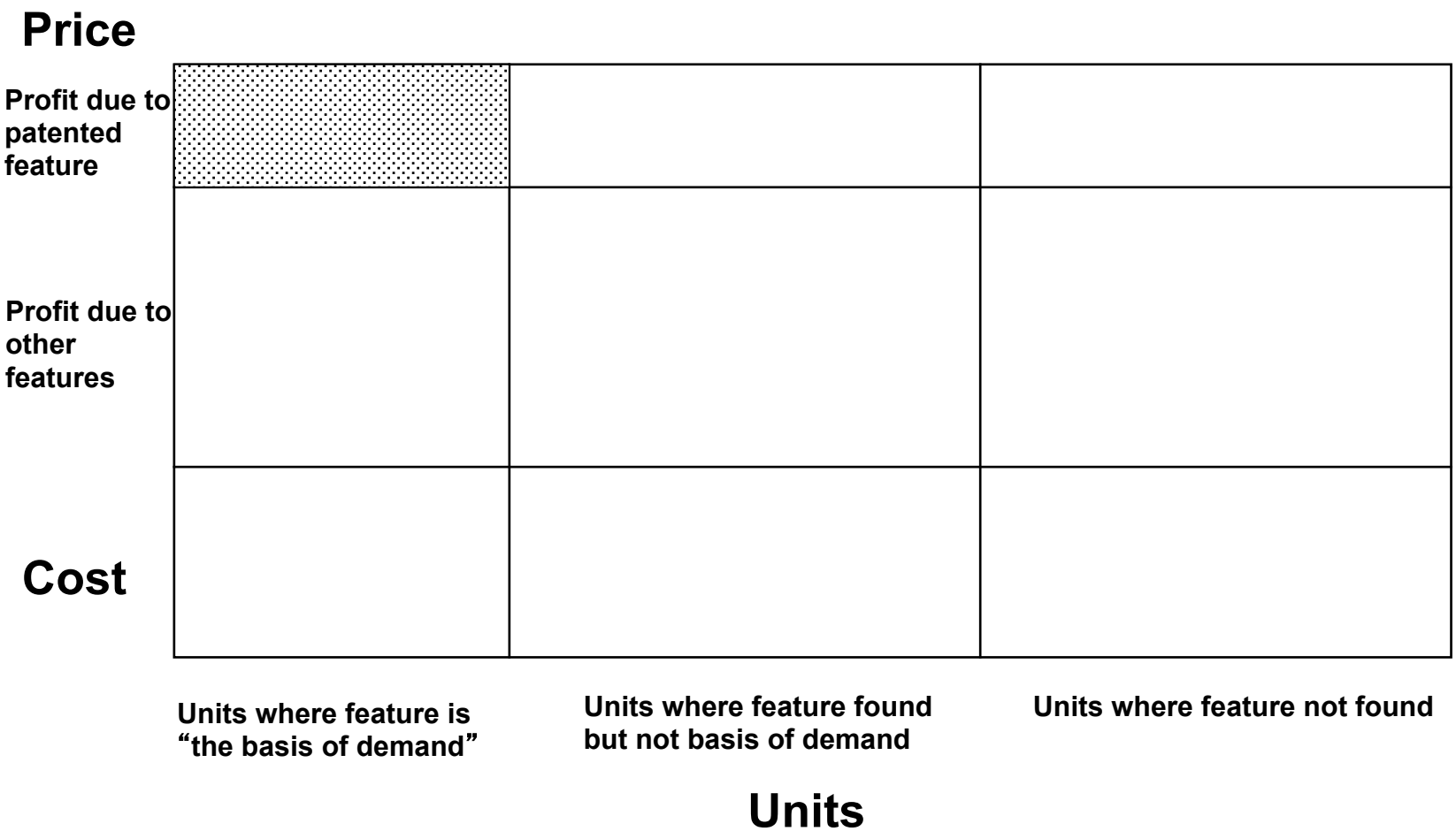
The Federal Circuit's "advance" – 1

- If profit must be apportioned, then revenue (the "royalty base") must be apportioned too
  - and you may have to apportion both quantity (to reflect "use") and price (to reflect multiple features)
- Problems:
  - no logical connection between the apportionment of profit and the use of revenue as a device to meter royalties
  - real-world licenses often do use revenue to meter royalties
  - now, can have an "established royalty" (factor 1), based on real licenses that use revenue to meter, but fails the new EMVR test

The Entire Market Value Rule

What Is It (Exactly)?



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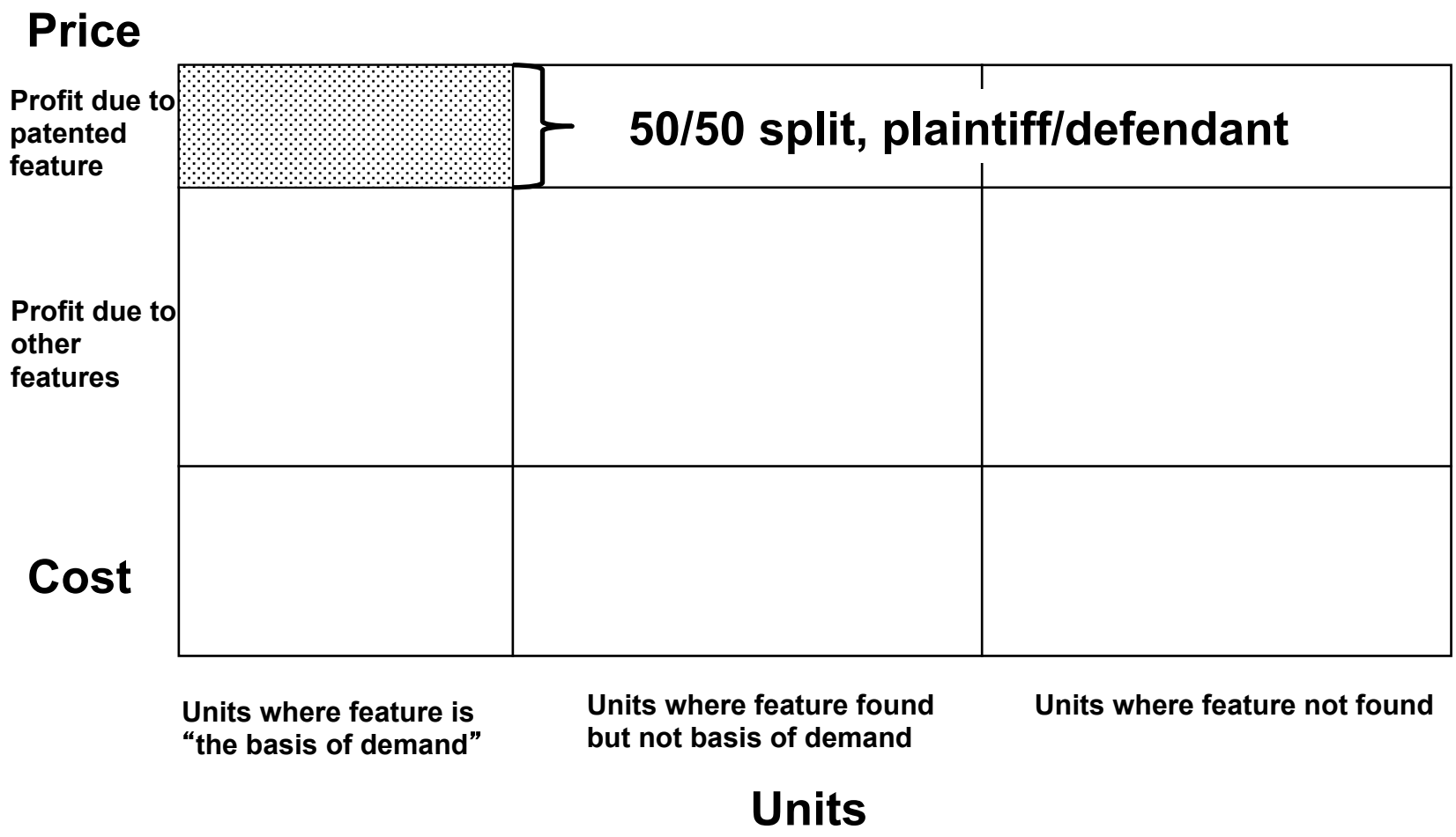
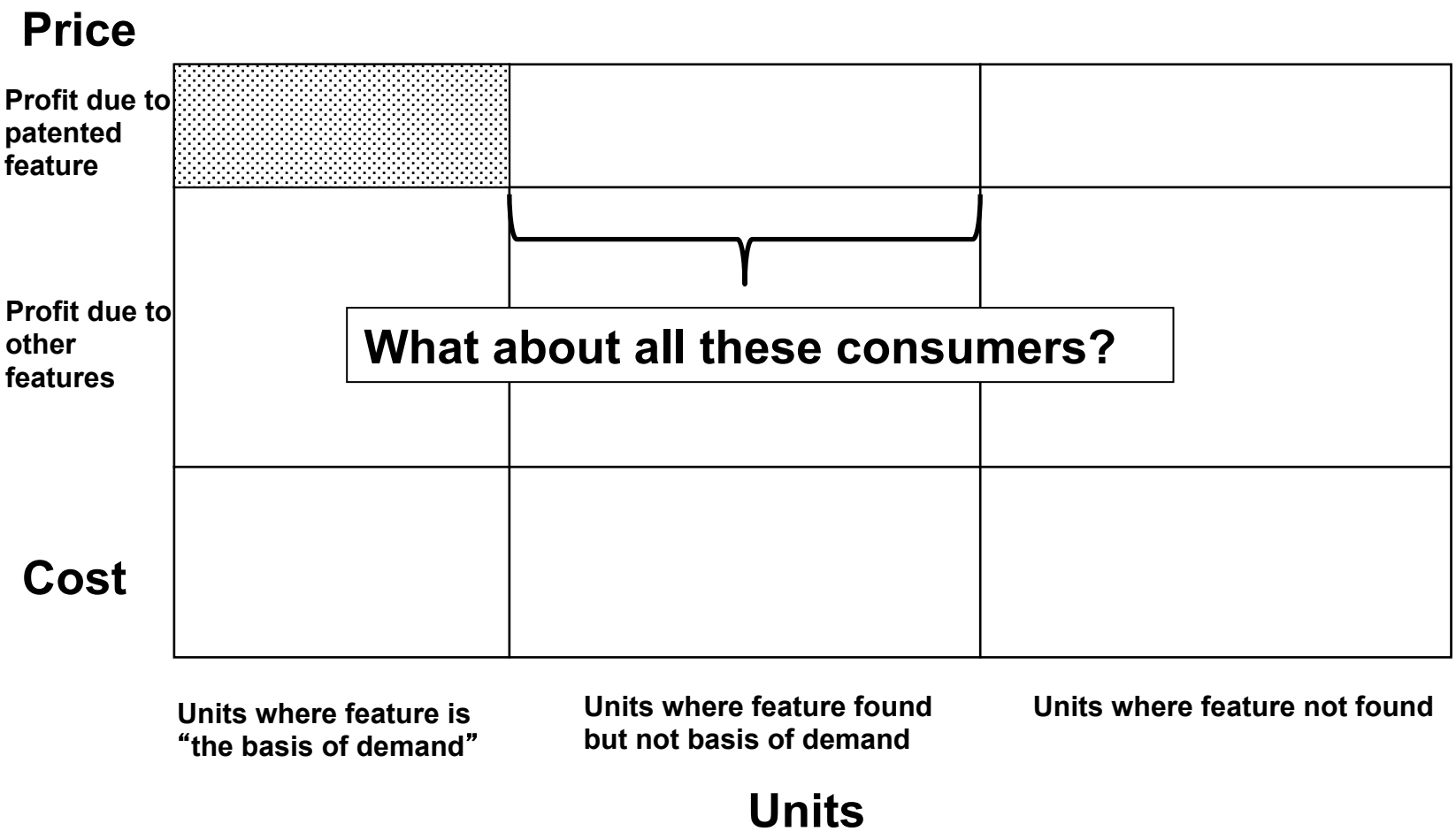


The Federal Circuit's "advance" – 2

- "The basis for demand" ➔ "but-for" demand
  - If X% of consumers would not buy a product without feature Y, then feature Y is the basis for that X%
  - *Example*: in *Lucent* retrial, survey evidence said 7% of consumers would not buy Outlook without the date-picker
- Problems:
  - What if the feature is the keyboard's "A" key, and X = 95% of consumers? Can the "B" key also be "the" basis for 95%?
  - Confuses the "apportionment of profit" with the "(unitary) causation of purchase" – contradicts basic economics
  - Does any invention pass this test? (Do you buy the drug or the FDA testing or the ad campaign or ... ?)

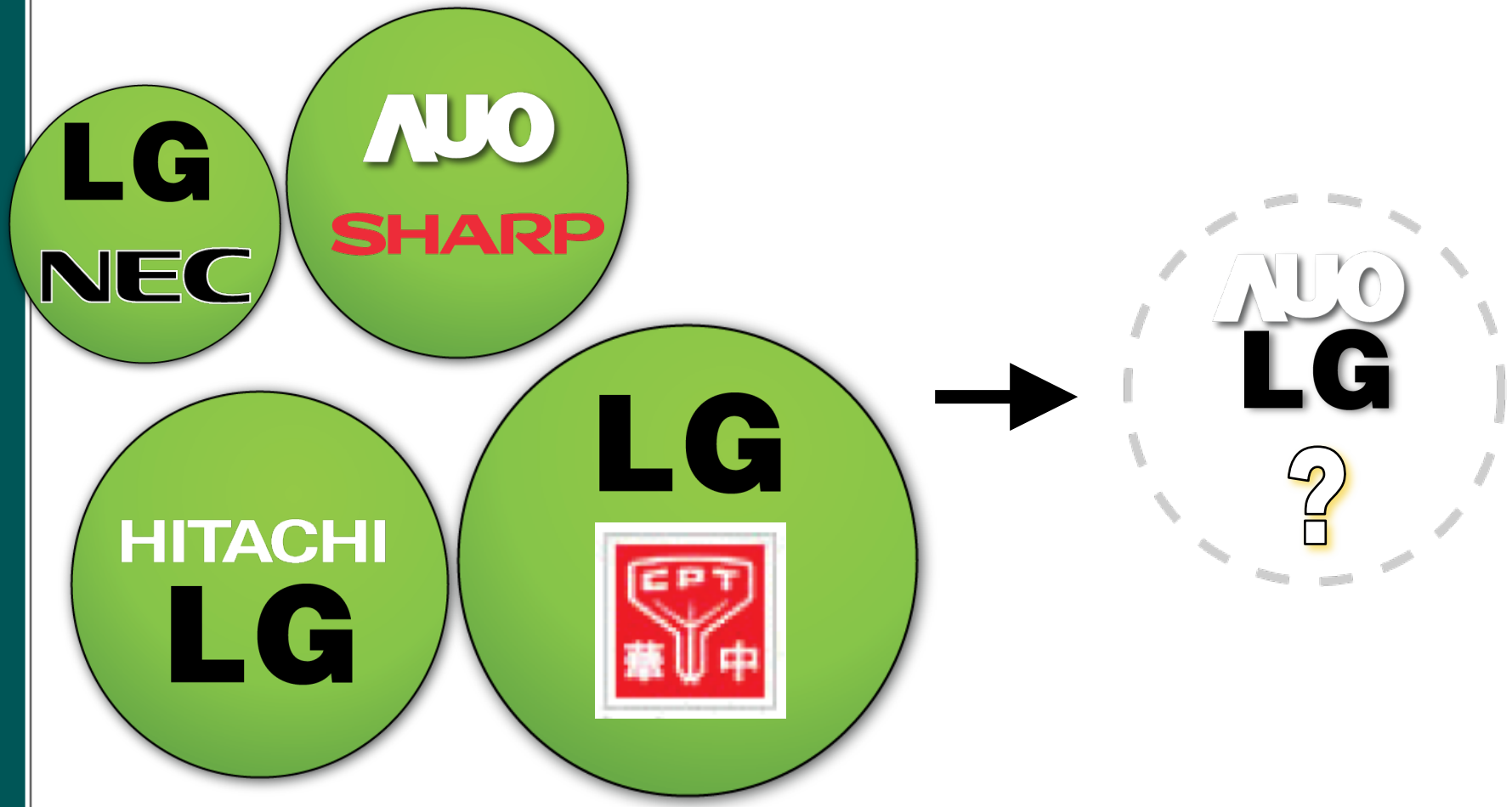
The Entire Market Value Rule

What Is It (Exactly)?



Explain Industry Cross-License Payments

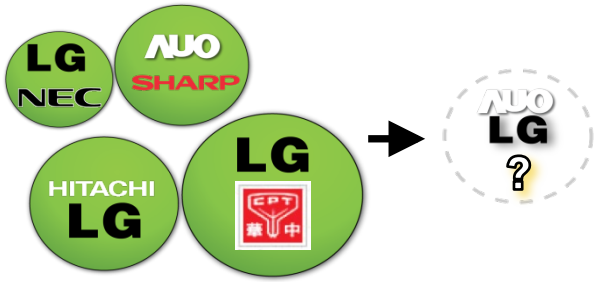
Regression analysis predicts an AUO-LGD deal



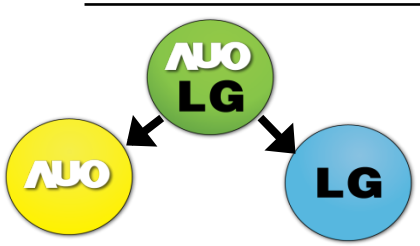
Apportionment – Example from Cross-Licensing

Three Steps

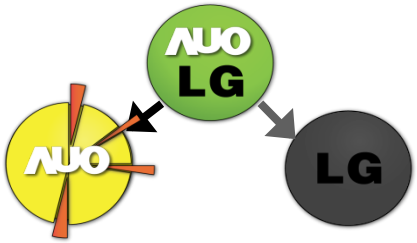
1. Predict the balancing payment between the parties



2. Decompose the balancing payment into component claims



3. Compute value shares for each party's patents



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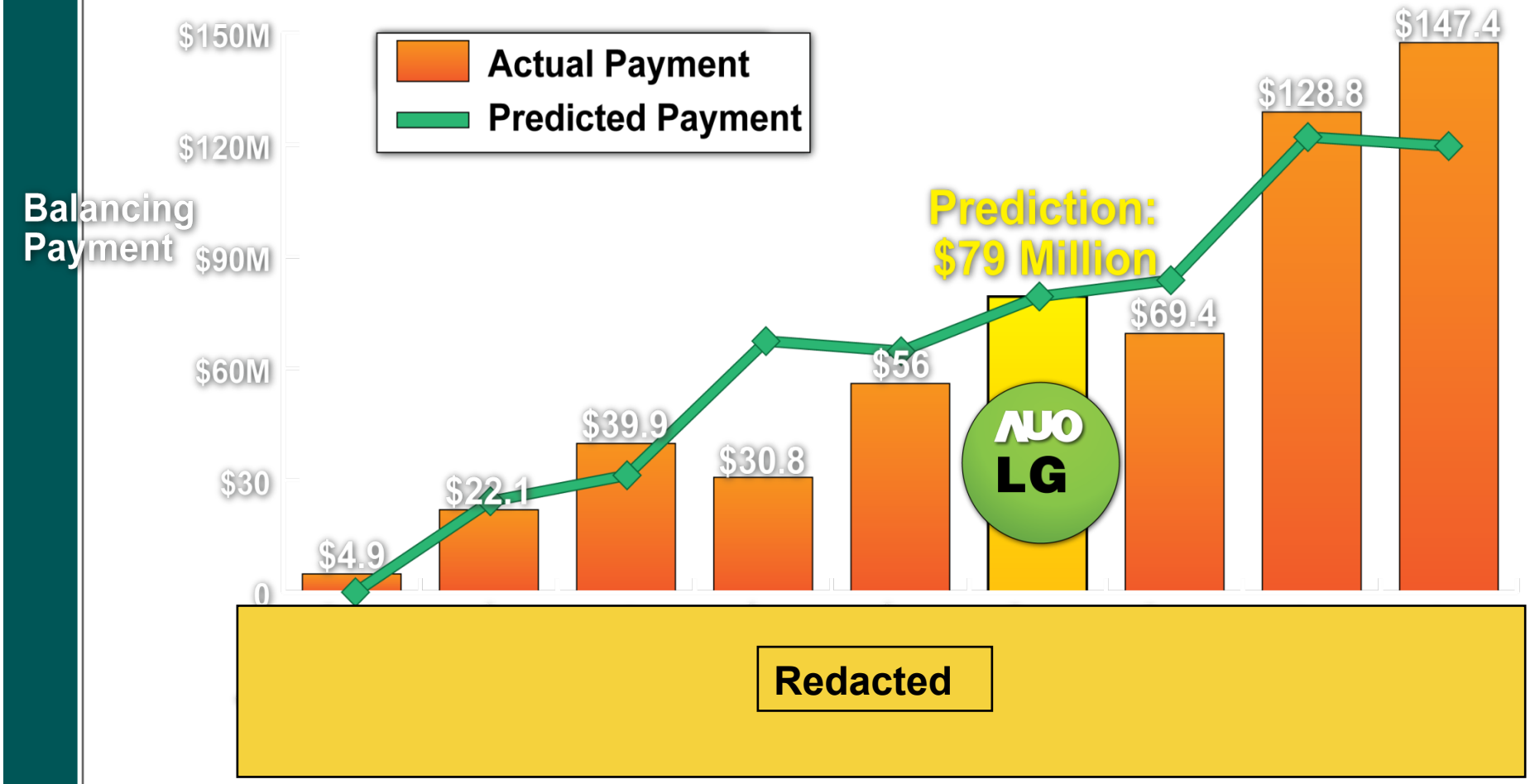

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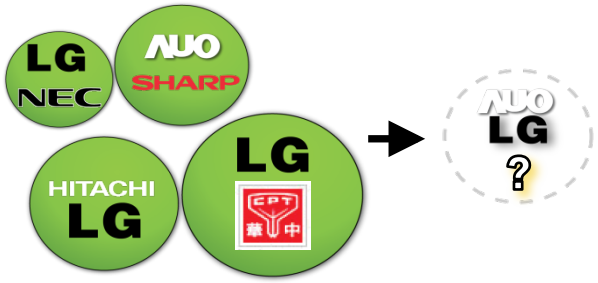

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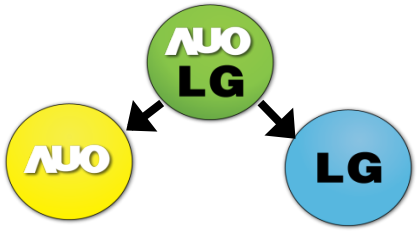

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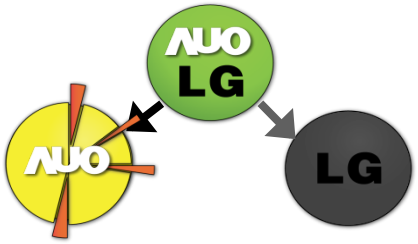
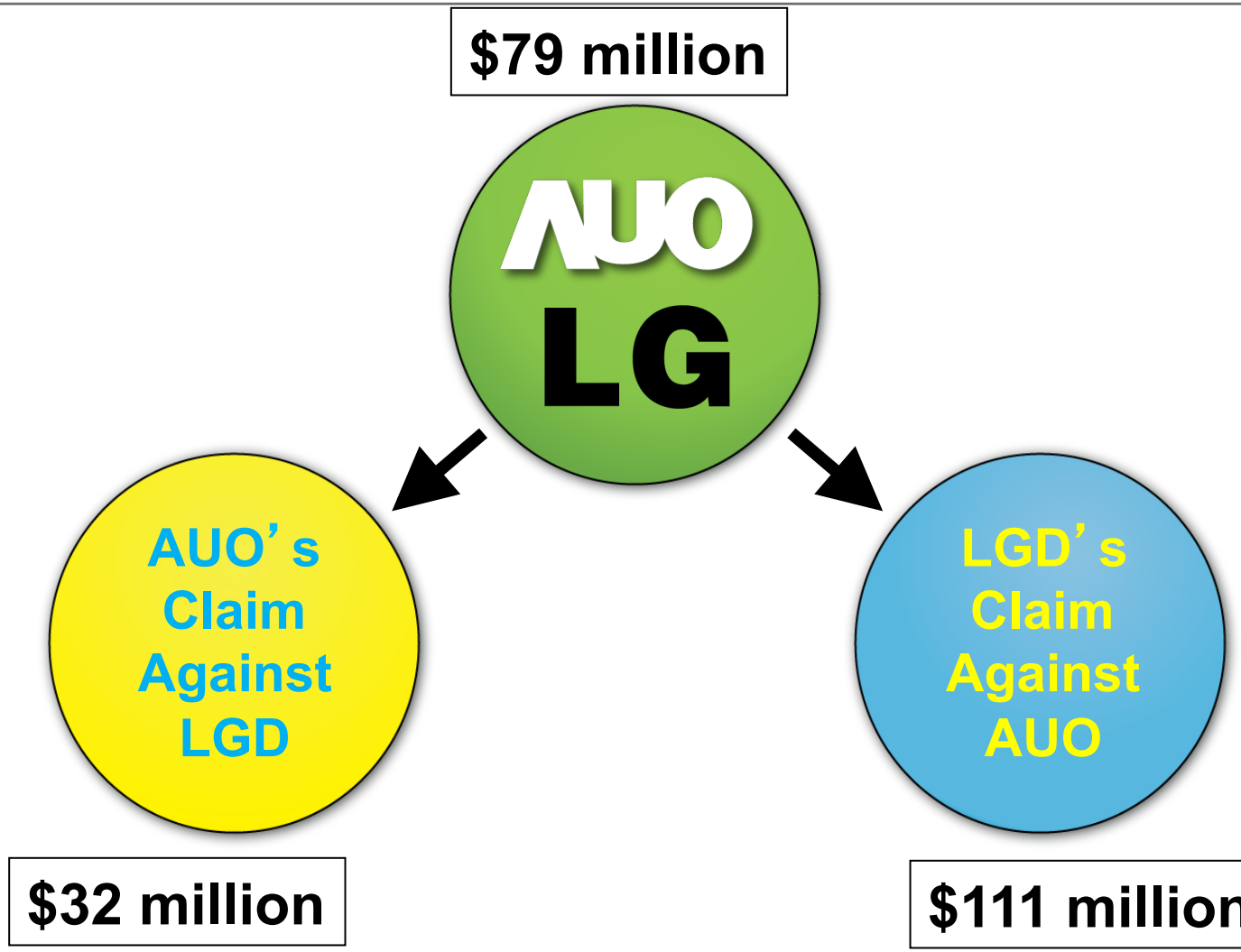


Decompose the balancing payment

Regression analysis identifies the component claims



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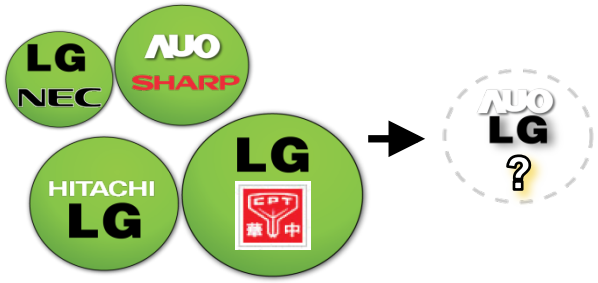

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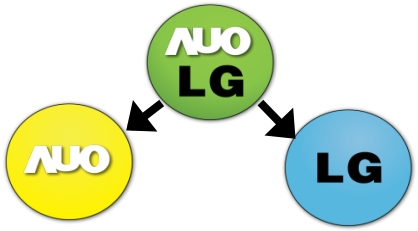

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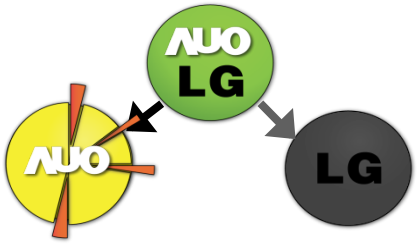
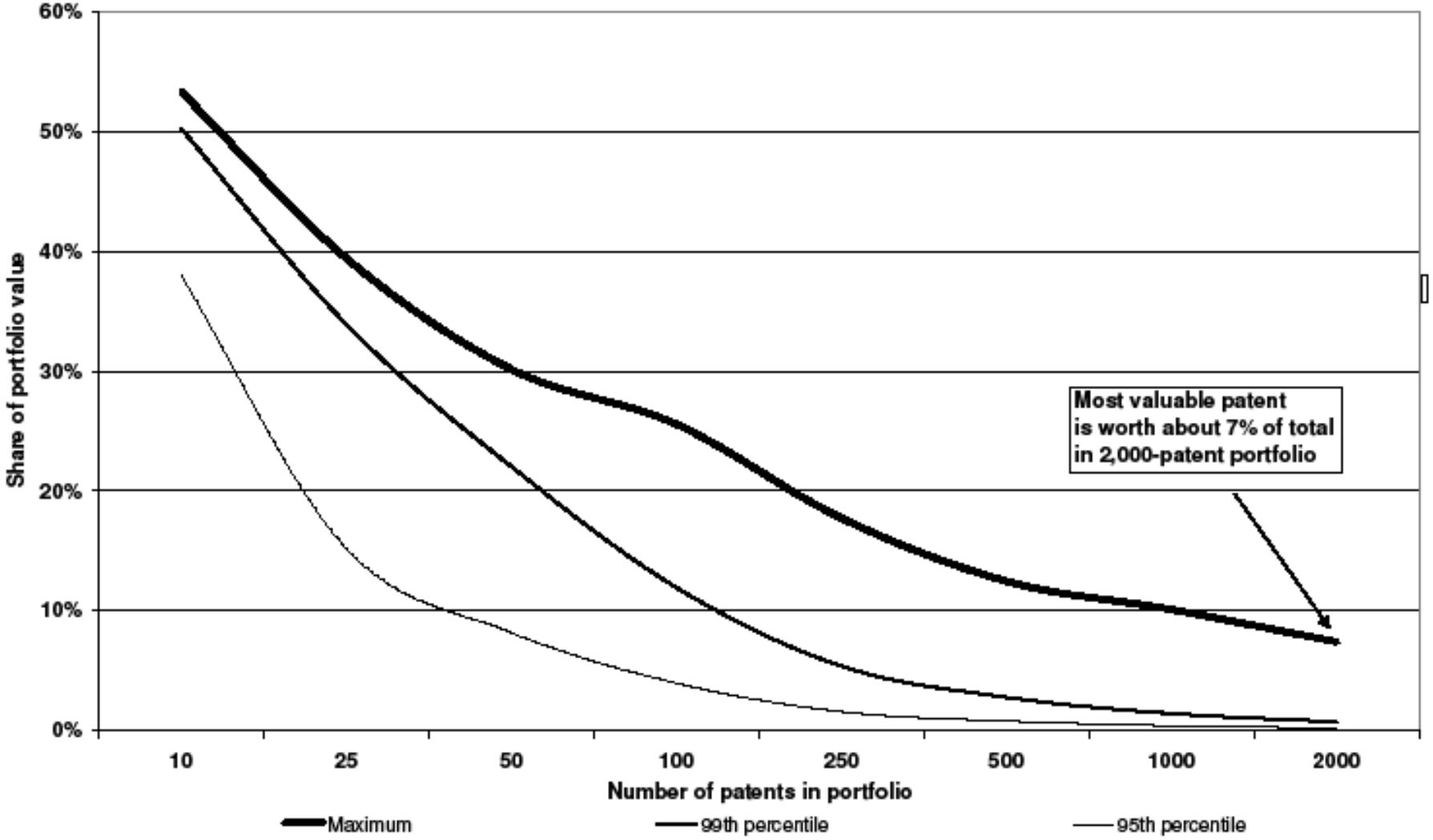


What if there were a way to apportion value to each patent in a portfolio?

- A "rule" that
  - derived from scientific literature
  - worked with portfolios having 100s of patents
  - applied to different fields of technology
- Simple and general assumptions
  - the value of two patents equals the sum of individual values
  - the individual values must add up to the portfolio total

Figure 3
Share of patent portfolio value based on portfolio size and patent rank within the portfolio



Source: See Figure 1.

Value Shares of Asserted Patents

The "Count, Rank and Divide" method

- Count
  - How many patents are in the portfolio
- Rank
  - Each patent by an objective indicator of importance
- Divide
  - Each party's claim into shares for each patent

The "ratio to the mean" rule

Percentile	Spread Low	Spread High
25%	0.1	0.0
50%	0.3	0.1
75%	0.8	0.5
90%	2.2	1.8
95%	3.9	3.6
99%	11.5	14.2

Value Shares of 4 Asserted AUO Patents

Patent	Value Share	Contribution to a Hypothetical License
'629	.37%	$148,000
'160	.32%	$130,000
'157	.06%	$24,000
'506	.01%	$3,500
Total	**.76%**	**$305,500**

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Apportionment and the EMVR Post-*Uniloc*

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